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Constitutional Implications on Block Pricing in the California Water Market

by DEEBA FAHAMI*

Introduction

Temperatures are warming, sea levels are rising, and heat waves are intensifying. The effects of global climate change are indisputable and the extent of these effects will continue to increase overtime. California, in particular, has experienced the realities of climate change with the recent historic drought that threatens California's water supply. Although droughts are a feature of California's climate, climate change models predict increases in the intensity and frequency of droughts.¹ California needs to prepare for the challenges of diminishing snowpack and increased rainfall variability.² Water supply management strategies should be implemented to reflect the increasing scarcity of fresh water and in anticipation to the changing hydrology and population growth.³

This Note encourages block water pricing structures as an economically and environmentally efficient pricing mechanism to integrate climate change into California water supply management. More specifically, this Note clarifies the judicial bounds of implementing block water pricing structures and explains the ramifications of the Fourth

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1. PUBLIC POLICY INSTITUTE OF CALIFORNIA, MANAGING DROUGHTS: CALIFORNIA MUST KEEP IMPROVING ITS ABILITY TO WEATHER DROUGHTS 1 (2016), http://www.ppic.org/content/pubs/report/R_1016JM2R.pdf.

2. PUBLIC POLICY INSTITUTE OF CALIFORNIA, CLIMATE CHANGE 4 (2015), http://www.ppic.org/content/pubs/report/R_215EHR.pdf.

3. PUBLIC POLICY INSTITUTE OF CALIFORNIA, CLIMATE CHANGE AND WATER 2 (2015), http://www.ppic.org/content/pubs/report/R_415CCWR.pdf.

District Court of Appeal decision, *Capistrano Taxpayers Association, Inc. v. City of San Juan Capistrano* (“*Capistrano*”), on municipalities’ water pricing systems. This Note concludes that *Capistrano*’s overbroad language casts constitutional doubt on conservation pricing structures and the notion that block-pricing structures can still comply with the terms set forth in the California Constitution. Moving forward, municipalities should take extra precaution in justifying each consumption level while taking into consideration future water supply.

I. Climate Change and California Water Supply

Since the 1980s, average global temperatures have been significantly higher than temperatures in the previous fifty years. Annual average temperatures have increased by about 1.5 degrees Fahrenheit per century.⁴ In fact, the warmest year on record was 2016, with sixteen of the seventeen warmest years on record occurring since 2001.⁵ Global climate is projected to continue to change over this century and beyond;⁶ even if all greenhouse gas emissions ceased today, some of the effects of climate change will be unavoidable.⁷ Greenhouse gases that have already been emitted are likely to remain in the atmosphere for thousands of years, and temperatures would likely continue to escalate following the cessation of emissions.⁸ These increased temperatures significantly affect our water resources. Global warming reduces snowfall, causes snowpack to melt earlier with higher winter runoff and winter floods, raises water temperatures, and amplifies the severity of droughts.⁹

California has already begun to experience the realities of climate change.¹⁰ Over the last one hundred years, a sea level rise of

4. *Id.*; OFFICE OF ENVIRONMENTAL HEALTH HAZARD ASSESSMENT, INDICATORS OF CLIMATE CHANGE IN CALIFORNIA 38 (2013), <http://oehha.ca.gov/multimedia/epic/pdf/ClimateChangeIndicatorsReport2013.pdf>.

5. Press Release, NASA, NASA, NOAA Data Show 2016 Warmest Year on Record Globally (Jan. 18, 2017), <https://www.nasa.gov/press-release/nasa-noaa-data-show-2016-warmest-year-on-record-globally>.

6. *The Consequences of Climate Change*, NASA (last updated March 27, 2017), <http://climate.nasa.gov/effects/>.

7. PUBLIC POLICY INSTITUTE OF CALIFORNIA, *supra* note 2, at 1.

8. Vince Stricherz, *If Greenhouse Gas Emissions Stopped Now, Earth Still Would Likely Get Warmer*, UW TODAY (Feb. 15, 2011), <http://www.washington.edu/news/2011/02/15/if-greenhouse-gas-emissions-stopped-now-earth-still-would-likely-get-warmer/>.

9. PUBLIC POLICY INSTITUTE OF CALIFORNIA, *supra* note 3.

10. *Id.*

approximately eight inches has been recorded at the Golden Gate Bridge.¹¹ Although there is no clear trend in annual precipitation in California,¹² precipitation was about 70% below average in 2013.¹³ The Sierra snowpack, an important source of water supply, has decreased by 10% in the past one hundred years and is expected to decrease by as much as 25% by 2050.¹⁴ And in 2015, the Sierra snowpack dipped to its lowest level in five hundred years.¹⁵ The increased temperatures combined with decreased winter snowfall and early rainwater runoff present a major threat to California's water supply.

With the recent historic drought in California, this threat is becoming a reality. On January 17, 2014, California Governor Edmund "Jerry" Brown Jr. proclaimed a State of Emergency due to the severe drought conditions.¹⁶ On April 25, 2014, Governor Brown proclaimed a Continued State of Emergency as a result of the sustained drought.¹⁷ These severe conditions have presented challenges to drinking water access in communities, water supply for agricultural production, habitat for fish and wildlife species, wildfire risks, and saltwater contamination to fresh water supplies in the Sacramento-San Joaquin Delta.¹⁸ In response, Governor Brown signed an executive order on April 1, 2015, to implement water conservation and urged water suppliers to develop rate structures and other pricing mechanisms to maximize water conservation consistent with statewide water restrictions.¹⁹ Despite these conservation efforts, California entered its fifth straight year of drought in 2016.²⁰ Governor Brown reinstated these executive orders on May 9, 2016, and established a new water-use efficiency framework for California that bolstered the state's drought resilience and preparedness by establishing longerterm water

11. CALIFORNIA AIR RESOURCES BOARD, CLIMATE CHANGE SCOPING PLAN: A FRAMEWORK FOR CHANGE 10 (2008), https://www.arb.ca.gov/cc/scopingplan/document/adopted_scoping_plan.pdf.

12. OFFICE OF ENVIRONMENTAL HEALTH HAZARD ASSESSMENT, *supra* note 4, at 63.

13. *Id.*

14. CALIFORNIA AIR RESOURCES BOARD, *supra* note 11, at 10.

15. Michael Casey, *Sierra Nevada Snowpack Lowest in 500 Years*, CBS NEWS (Sept. 14, 2015, 2:12 PM), <http://www.cbsnews.com/news/sierra-nevada-snowpack-lowest-in-500-years/>.

16. Cal. Exec. Order No. B-29-15 (Apr. 1, 2015), https://www.gov.ca.gov/docs/4.1.15_Executive_Order.pdf.

17. *Id.*

18. *Id.*

19. *Id.* at 3.

20. Cal. Exec. Order No. B-37-16 (May 9, 2016), https://www.gov.ca.gov/docs/5.9.16_Executive_Order.pdf.

conservation measures.²¹ Early rains in 2017 have provided an encouraging start to the year, and on April 7, 2017, Governor Brown terminated the drought state of emergency for all counties in California except Fresno, Kings, Tulare, and Tuolumne.²² Despite the official ending of the drought state of emergency, the hydrological effects of the drought will take years to recover from.²³

In light of the historic five-year drought, Californians should continue discretionary use of the state's water resources to mitigate the effects of climate change. Tiered water pricing, in particular, is an effective regulatory control to encourage water conservation.²⁴ This Note supports progressive block-pricing structures and explains the legal precedent that governs its implementation.

II. Price Mechanisms as a Market Solution for Diminished Water Supply

In basic economic theory, the market price of a good is set where the demand meets supply. Achieving the economically efficient allocation of a particular good occurs when profits are maximized. Put differently, the optimal allocation of a good occurs when total benefits are maximized while reducing the total costs. Unlike most commodities, however, water is a finite and vulnerable resource that is essential to sustain life, development, and the environment.²⁵ Water has therefore, been excluded from market competition and is generally not priced at market rates.²⁶ Instead, where water is provided by a local public agency, water rates generally only allow the agency to recover the cost of providing the service.²⁷ California applies this "at-cost" requirement very strictly.

21. *Id.*

22. Cal. Exec. Order No. B-40-17 (Apr. 7, 2017), https://www.gov.ca.gov/docs/4.7.17_Exec_Order_B-40-17.pdf.

23. *Is the Drought Over?*, USGS (last updated Apr. 18, 2017), <https://ca.water.usgs.gov/data/drought/> (stating that groundwater aquifer recovery has not been remedied by the recent weather); Paul Rogers, *How the Drought Changed California Forever*, THE MERCURY NEWS (Oct. 15, 2017, 9:45 AM), <http://www.mercurynews.com/2017/04/15/how-the-drought-changed-california-forever/>.

24. *State Water Board Drought Year Actions: Conservation Water Pricing*, CALIFORNIA ENVIRONMENTAL PROTECTION AGENCY: STATE WATER RESOURCES CONTROL BOARD (Oct. 26, 2016), http://www.waterboards.ca.gov/waterrights/water_issues/programs/drought/pricing/.

25. International Conference on Water and the Environment, *The Dublin Statement on Water and Sustainable Development* (Jan. 26-31, 1992), www.undocuments.net/h2o-dub.htm.

26. Gregory S. Weber, *A New Water Accounting*, 40 *ECOLOGY L.Q.* 795, 797 (2013).

27. *Id.*

In 1996, California adopted Proposition 218, which added Article XIII C and Article XIII D to the California Constitution.²⁸ These amendments protect taxpayers by limiting the methods in which local governments can create or increase tax, fees, and charges without taxpayer consent.²⁹ Proposition 218 established substantive limitations for fees and charges levied “as an incident of property ownership” or for a “property-related service.”³⁰ Water rates and other service fees for ongoing delivery imposed on current customers of a public agency are fees and charges subject to Proposition 218.³¹ In accordance with these provisions, a property-related fee must meet all the requirements set forth in Article XIII D, sections 6(b)(1)–(5):

(1) Revenues derived from the fee or charge shall not exceed the funds required to provide the property related service.

(2) Revenues derived from the fee or charge shall not be used for any purpose other than that for which the fee or charge was imposed.

(3) The amount of a fee or charge imposed upon any parcel or person as an incident of property ownership *shall not exceed the proportional cost of the service* attributable to the parcel.

(4) No fee or charge may be imposed for a service unless that service is actually used by, or immediately available to, the owner of the property in question. Fees or charges based on potential or future use of a service are not permitted. Standby charges, whether characterized as charges or assessments, shall be classified as assessments and shall not be imposed without compliance with Section 4.

28. *What is Proposition 218?*, CALIFORNIA TAX DATA, <http://www.californiataxdata.com/pdf/proposition218.pdf>.

29. *Id.*; CAL. CONST. art. XIII C.

30. CAL. CONST. art. XIII D, §§ 3–4, 6. In addition, Proposition 218 creates two procedural requirements that public water agencies must fulfill before adopting a property-related fee or charge: (1) the agency must conduct a public hearing on the proposed change in rates, fees, or rate structure; and (2) property-related fees except those for water, sewer, or refuse collection services must be approved by local voters. CAL. CONST. art. XIII D, § 6, cl. a & c.

31. *Bighorn-Desert View Water Agency v. Verjil*, 138 P.3d 220, 225–26 (Cal. 2006).

(5) No fee or charge may be imposed for general governmental services including, but not limited to, police, fire, ambulance or library services, where the service is available to the public at large in substantially the same manner as it is to property owners. Reliance by an agency on any parcel map, including, but not limited to, an assessor's parcel map, may be considered a significant factor in determining whether a fee or charge is imposed as an incident of property ownership for purposes of this article. In any legal action contesting the validity of a fee or charge, the burden shall be on the agency to demonstrate compliance with this article.³²

Proposition 218 places limitations on the revenue collected from property-related fees and the allocation of costs recovered by such fees and charges to ensure that water customers are not charged more than the proportional cost of supplying water to a particular parcel.³³ In short, Proposition 218 requires that municipalities charge at-cost water prices, unless there is approval by popular vote that allows otherwise.³⁴

Although politically popular, at-cost water prices³⁵ set by an agency or municipality have been historically underpriced.³⁶ At-cost pricing values water at the fixed costs of delivery, which encompasses only operation and maintenance costs.³⁷ This price fails to take into account the costs of the negative externalities of water supply such as environmental detriment, intergenerational equity, and scarcity.³⁸ At-cost pricing misrepresents water's value because it assumes that water itself is free. As a result, at-cost pricing fails to discourage water waste.³⁹ Greater efficiency is needed

32. CAL. CONST. art. XIII D, § 6, cl. (b)(1)–(5) (emphasis added).

33. Application for Leave to File Amicus Curiae Brief by Natural Resources Defense Council and Planning and Conservation League; Brief of Amici Curiae in Support of Appellants, *Capistrano Taxpayers Ass'n, Inc. v. City of San Juan Capistrano*, 186 Cal. Rptr. 3d 362 (Cal. Ct. App. 2015) (No. G048969), 2014 WL 2680792.

34. Weber, *supra* note 26, at 797.

35. For the purposes of this Note, "water price(s)" refers to public municipal or utility water prices.

36. Weber, *supra* note 26, at 798.

37. *Id.*

38. See Bourree Lam, *Finding the Right Price for Water*, THE ATLANTIC (Mar. 24, 2015), <https://www.theatlantic.com/business/archive/2015/03/finding-the-right-price-for-water/388246/>.

39. Water presents a classic tragedy of the commons scenario: In pursuing their best interests, a rational man or woman will deplete resources without limitations. The freedom to deplete resources results in ruin for all as finite resources are depleted to exhaustion. See Garrett

to prepare for increased pressures on fresh water resources as a result of climate change.

A market-based solution to cost recovery in the water market is a tiered (or increasing block) pricing structure.⁴⁰ In block pricing, the rate per unit of water increases as the volume of consumption increases.⁴¹ The first tier is charged the lowest rate, the next tier is charged a higher rate, and so forth.⁴² This system encourages conservation because it disincentivizes heavy water use.⁴³ It also appeals to societal objectives to ensure that people enjoy affordable water by providing low water users with the lowest price.⁴⁴ This pricing scheme is criticized, however, for potential hardships placed on low-income families⁴⁵ who must pay a set rate regardless of their consumption.⁴⁶ Despite this, studies have confirmed that block water pricing encourages water efficiency while addressing equity concerns and keeping the overall prices low.⁴⁷

As a result of water conservation concerns, California water utilities have increasingly adopted tiered water pricing structures.⁴⁸ By 2006, about half of California's population lived in a service area with tiered rates, and the number of service areas have increased in response to drought conditions.⁴⁹ All ten large investor-owned water utilities in California

Hardin, *The Tragedy of the Commons*, 162 SCI. 1243 (1968). With the increasing population and reductions in water supply from climate change, our water supply is diminishing at a faster rate than natural forces are able to replenish the water supply.

40. Janny Choy, *Pricing Water for Conservation Using Tiered Water Rates Structures: Q&A with Stanford Economics Professor Frank Wolak*, STANFORD: WATER IN THE WEST (Apr. 24, 2015), <http://waterinthewest.stanford.edu/news-events/news-press-releases/pricing-water-conservation-using-tiered-water-rates-structures-qa>.

41. *Id.*

42. *Id.*

43. *Water Pricing – Increasing Block Tariffs*, SUSTAINABLE SANITATION & WATER MANAGEMENT, <http://www.sswm.info/content/water-pricing-increasing-block-tariffs>.

44. *Id.*

45. *A Primer on Water Pricing in the San Diego Region*, EQUINOX CENTER 5 (Oct. 2009), https://energycenter.org/sites/default/files/Equinox%20Water_Pricing_Brief%20102609.pdf.

46. In turn, this could encourage low water consumers to consume more water up to the point where their consumption would place them in a higher tier.

47. A study done by Kenneth Baerenklau, Associate Professor of Environmental Economics and Policy at the University of California, Riverside, showed that average household's water use was approximately 15% below what it would have been under a flat price structure with equivalent average prices and that the average price paid for water rose only 4% under water budgets. Flat rate prices would have had to increase by 30% to get the same 15% reduction. Iqbal Pittalwala, *An Innovative Approach to Promote Water Use Efficiency*, UCR TODAY (Feb. 19, 2014), <http://ucrtoday.ucr.edu/20653>.

48. *Id.*

49. Brian Gray, *Paying for Water in California: The Legal Framework*, 65 HASTINGS L.J. 1603, 1635 (2014).

adopted tiered rate structures in the late 2000s.⁵⁰ Adopting tiered prices as part of municipal water rate reform promotes conservation in a flexible and fiscally responsible way.⁵¹

The California Legislature expressly authorizes water suppliers to use allocation-based conservation pricing, such as block structures, to ensure the reasonable use of water.⁵² Water suppliers can set a “basic use allocation,” providing a reasonable amount of water for the customer’s needs and property characteristics and providing incrementally higher rates for use in excess of the basic use allocation.⁵³ Volumetric prices that are economically structured to encourage conservation and reduce the inefficient use of water are permissible.⁵⁴ Undeniably, water conservation efforts such as these can play a major role in mitigating the effects of supply reductions from climate change.⁵⁵

III. The *Capistrano* Decision

Capistrano Taxpayers Association, Inc. v. City of San Juan Capistrano arose from a challenge to a tiered water rate structure implemented by the City of San Juan Capistrano (“City”).⁵⁶ The rate structure identified classes of consumers by type and size of property and developed four budgets for each class based on prior usage patterns: (1) low, (2) reasonable, (3) excessive, and (4) very excessive.⁵⁷ The City did not try to calculate the incremental cost of providing water at each consumption level, but instead, it allocated total costs in such a way “that the anticipated revenues from all four tiers would equal total costs”⁵⁸ In fact, the City effectively used revenues from the top tiers to subsidize the rates of the bottom tiers. The City justified these rates as conservation rates in that the highest rates were imposed on the highest consumers of water.⁵⁹ An association of taxpayers challenged this rate system asserting that the

50. *Id.*

51. *A Primer on Water Pricing in the San Diego Region*, *supra* note 45, at 1 (“Water conservation is maximized when tiered rates are implemented.”); Ellen Hanak, et al., *Managing California’s Water: From Conflict to Reconciliation*, PUBLIC POLICY INSTITUTE OF CALIFORNIA 311 (2011), http://www.ppic.org/content/pubs/report/R_211EHR.pdf.

52. CAL. WATER CODE § 370 (West 2009).

53. *Id.* § 372(a)(2)–(4).

54. *Id.*

55. Hanak, et al., *supra* note 51.

56. *Capistrano Taxpayers Ass’n, Inc. v. City of San Juan Capistrano*, 186 Cal. Rptr. 3d 362, 364 (Cal. Ct. App. 2015).

57. *Id.* at 367–68.

58. *Id.* at 366.

59. *Id.* at 367–68, 378–79.

City's new rate structure violated Proposition 218's mandate to price water proportional to the cost of the service. Before discussing the results of this challenge, however, it is useful to summarize the judicial limitations of water pricing mechanisms in California leading up to the *Capistrano* decision.

The relevance of Proposition 218 in water ratemaking largely turns on the meaning of "fees and charges" defined in Article XIII D, section 2,⁶⁰ which was interpreted by the California Supreme Court in *Bighorn-Desert View Water Agency v. Verjil*.⁶¹ In *Bighorn*, the court held that once a property owner or resident pays connection charges and becomes a customer of a public water agency, *all* charges,⁶² including water rate and delivery, thereafter are property-related service charges within the meaning of Article XIII D and Article XIII C, section 3 of the California Constitution.⁶³ A key inquiry in the case was whether or not the property owner or tenant was a customer of the public water agency.⁶⁴ In effect, the holding in *Bighorn* affirmed that water rates are within the scope of Proposition 218.

Following *Bighorn*, the California Supreme Court clarified that agencies bear the burden of proof to demonstrate Proposition 218 compliance in *Silicon Valley Taxpayers Association, Inc. v. Santa Clara County Open Space Authority*. Thus, in proving the proportionality requirement, the water agency has the burden of demonstrating that the contested assessment is proportional to, and no greater than, the benefits conferred on the property in question.⁶⁵ The agency's determinations regarding whether the benefits are proportional under the California Constitution must withstand an independent standard of review.⁶⁶

60. CAL. CONST. art. XIII D, § 2, cl. (e) ("‘Fee’ or ‘charge’ means any levy other than an ad valorem tax, a special tax, or an assessment, imposed by an agency upon a parcel or upon a person as an incident of property ownership, including a user fee or charge for a property related service.”).

61. *Bighorn-Desert View Water Agency v. Verjil*, 138 P.3d 220, 229 (Cal. 2006).

62. *Id.* at 227. “All charges” include whether the charge is calculated on the basis of consumption or imposed as a fixed monthly fee.

63. *Id.*; see also *Richmond v. Shasta Comm. Servs. Dist.*, 83 P.3d 518, 528 (Cal. 2004) (clarifying that a water service fee is a fee or charge under Article XIII D if, but only if, it is imposed “upon a person as an incident of property ownership”).

64. ASSOCIATION OF CALIFORNIA WATER AGENCIES, PROPOSITION 218: LOCAL AGENCY GUIDELINES FOR COMPLIANCE 9 (2007), <http://www.acwa.com/products/acwa-issue-guidelines/proposition-218-local-agency-guidelines-compliance>.

65. *Silicon Valley Taxpayers Ass’n, Inc. v. Santa Clara Cty. Open Space Auth.*, 187 P.3d 37, 48 (Cal. 2008).

66. *Id.* at 49.

The *City of Palmdale v. Palmdale Water District* later applied this standard of review to strike down a tiered rate structure adopted by the Palmdale Water District.⁶⁷ In *Palmdale*, the district adopted a tiered rate structure to encourage efficient use of its surface and groundwater sources of supply.⁶⁸ The *Palmdale* Court focused on the lack of justification in the record for the differences in the costs of providing water service to each customer class and also emphasized the importance of promoting efficient water use and management.⁶⁹ In *Palmdale*, the court affirmed that tiered water pricing structure constitutes a “fee or charge” for the purposes of Proposition 218 and that water conservation pricing is constitutional so long as the price does not exceed the proportional cost of the service to the parcel.⁷⁰

In the case *Griffith v. Pajaro Valley Water Management Agency*, the California Court of Appeal issued a countervailing interpretation of Proposition 218. There, the court addressed the legality of that agency’s groundwater augmentation charge pursuant to Proposition 218. The charge involved a tiered charge imposed for groundwater distribution based on the geographical differences in the parcels.⁷¹ The court held that the groundwater augmentation charges did not improperly exceed proportional costs attributable to the parcel, noting that water agencies manage resources for the common benefit for all water users.⁷²

Looking at this line of cases, the *Capistrano* Court ultimately held that: (1) Proposition 218 allows the City to pass the capital costs of building a water recycling plant on to its customers, but the record was unclear whether the rates for the capital investments of the recycling operation were improperly allocated to lower-than-average users whose consumptions did not require water recycling;⁷³ and (2) the City’s tiered rate pricing structure violates the constitutional requirement that fees not exceed the proportional costs of service attributable to the parcel because

67. *City of Palmdale v. Palmdale Water Dist.*, 131 Cal. Rptr. 3d 373 (Cal. Ct. App. 2011). The court rejected the argument that tiered rates were authorized by Article X, section 2, of the California Constitution because the tiered rates were designed to prevent unreasonable water use. Article X, section 2 of the California Constitution is the reasonable and beneficial use doctrine, which mandates that all water use must be reasonable.

68. *Id.*

69. *Id.* at 374.

70. *Id.* at 379.

71. *Griffith v. Pajaro Valley Water Mgmt. Agency*, 163 Cal. Rptr. 3d 243 (Cal. Ct. App. 2013).

72. *Id.* at 254–55.

73. *Capistrano Taxpayers Ass’n, Inc. v. City of San Juan Capistrano*, 186 Cal. Rptr. 3d 362, 369–71 (Cal. Ct. App. 2015).

the City did not carry its burden of proving that the rates of the higher tiers reflect the costs of service.⁷⁴ The central focus of this Note is this second holding, which in and of itself does not create any additional judicial limitations to water rate jurisprudence.⁷⁵

Despite this holding, *Capistrano* has been surrounded by extreme controversy. Governor Brown issued a statement describing the decision as putting a “straightjacket” on government efforts responding to the severe drought conditions.⁷⁶ There have also been two requests to depublish the opinion. The first request came from then-California Attorney General, Kamala Harris, on behalf of the State Water Resources Control Board, and the second request was from the Association of California Water Agencies, California State Association of Counties, and League of California Cities (collectively “Amici Associations”).⁷⁷ Much of the concern following *Capistrano*, however, is not directed at the central holdings of the case but

74. *Id.* at 380–81. The analysis of this Note focuses on this second holding.

75. *Bighorn-Desert View Water Agency v. Verjil*, 138 P.3d 220 (Cal. 2006); *City of Palmdale v. Palmdale Water Dist.*, 131 Cal. Rptr. 3d 373 (Cal. Ct. App. 2011); *Silicon Valley Taxpayers Ass’n, Inc. v. Santa Clara Cty. Open Space Auth.*, 187 P.3d 37, 48 (Cal. 2008).

76. Governor Brown issued a statement on April 20, 2015: “The practical effect of the court’s decision is to put a straitjacket on local government at a time when maximum flexibility is needed. My policy is and will continue to be: employ every method possible to ensure water is conserved across California.” Edmund G. Brown Jr., *Governor Brown Issues Statement on 4th District Court of Appeal Decision*, OFFICE OF GOVERNOR EDMUND G. BROWN JR. (Apr. 20, 2015), <https://www.gov.ca.gov/news.php?id=18928>.

77. Former Attorney General, Kamala Harris, issued a request to depublish the opinion on behalf of the State Water Resources Control Board, stating that the Court of Appeal’s *dicta* could be read to cast constitutional doubt on any price structure that imposes a penalty rate for excessive water use and create confusion regarding Article X, section 2 of the California Constitution. This request further stated that the opinion “could impede the State’s ability to achieve the reductions in water use required by the Governor’s Executive Order.” Kamala D. Harris, *Request for Depublication*, STATE WATER RESOURCES CONTROL BOARD (June 5, 2015), http://www.waterboards.ca.gov/waterrights/water_issues/programs/drought/pricing/docs/capistrano_depуб_request.pdf. The League of California Cities, Association of California Water Agencies, and California State Associations of Counties collectively submitted a request for depublication on June 12, 2015, on the grounds that: “(1) the Opinion fails to harmonize provisions of the California Constitution [A]rticle XIII D, section 6 and Article X, Section 2; (2) it fundamentally misconstrues the nature and scope of the service provided by the public water providers; and (3) it fails to appropriately consider the judgments of local public agencies in making the determination necessary to assure that fees imposed as an incident of property ownership do not exceed ‘the proportional costs of the service attributable to the parcel[s]’ as required by [A]rticle XIII D, section 6, subd. (b)(3).” League of California Cities, *Request for Depublication*, ASSOCIATION OF CALIFORNIA WATER AGENCIES (June 12, 2015), http://www.acwa.com/sites/default/files/news/state-budget-fccs/2015/06/capistrano-taxpayers-association-city-san-juan-capistrano_request.pdf; Howard Mintz, *California Drought: High Court Hands Setback to Water Conservation Fight*, SAN JOSE MERCURY NEWS (July 23, 2015, 9:52 AM), http://www.mercurynews.com/drought/ci_28523832/california-drought-high-court-hands-setback-water-conservation.

at the overbroad and questionable language used throughout the opinion, which is described in greater detail below.⁷⁸

First, the court in *Capistrano* embarks on a lengthy and confusing discussion on the nexus of Proposition 218 and Article X, section 2 of the California Constitution. Article X, section 2⁷⁹ enumerates the “reasonable and beneficial use” doctrine, which establishes that all uses of water must conform to the standard of reasonable use.⁸⁰ What is reasonable depends on the circumstances of each case and cannot be resolved without considering important statewide concerns.⁸¹ The City justified its pricing regime by arguing that Proposition 218’s cost of service principle must be balanced against this conservation mandate of Article X, section 2.⁸² The court rejected the notion that Article X, section 2 excused the City from the substantive requirements in Proposition 218. Given that the City had already acknowledged that it did not even try to calculate the incremental cost of providing water for each tier,⁸³ the discussion of Article X, section 2 should have ended there.

Instead, the opinion launched into a discussion regarding the origins and interpretation of Article X, section 2, concluding that, if push came to shove, Proposition 218 might be read to carve out an exception to Article X, section 2 because Proposition 218 is more recent and more specific.⁸⁴ There was no explanation for why Proposition 218—which deals with

78. “Opinion” is used as shorthand for *Capistrano*.

79. CAL. CONST. art X, § 2:

It is hereby declared that because of the conditions prevailing in this State the general welfare requires that the water resources of the State be put to beneficial use to the fullest extent of which they are capable, and that the waste or unreasonable use or unreasonable method of use of water be prevented, and that the conservation of such waters is to be exercised with a view to the reasonable and beneficial use thereof in the interest of the people and for the public welfare. The right to water or to the use or flow of water in or from any natural stream or water course in this State is and shall be limited to such water as shall be reasonably required for the beneficial use to be served, and such right does not and shall not extend to the waste or unreasonable use or unreasonable method of use or unreasonable method of diversion of water. . . . This section shall be self-executing, and the Legislature may also enact laws in the furtherance of the policy in this section contained.

Id.

80. Nat’l Audubon Soc’y v. Superior Court, 658 P.2d 709, 725–26 (Cal. 1983).

81. Joslin v. Marin Mun. Water Dist., 429 P.2d 889, 894–95 (Cal. 1967).

82. *Capistrano Taxpayers Ass’n, Inc. v. City of San Juan Capistrano*, 186 Cal. Rptr. 3d 362, 372–73 (Cal. Ct. App. 2015).

83. *Id.* at 366–67.

84. *Id.* at 377.

property-related fees or charges—is more specific than Article X, section 2, which only deals with water use.⁸⁵ The court later conceded that this statement was unnecessary to its analysis,⁸⁶ however this statement may frustrate water service providers' future efforts to harmonize the two provisions and could imply a partial repeal of Article X, section 2.⁸⁷

Second, the court's application of *Palmdale*—which concluded that Article X, section 2 is not at odds with Proposition 218 so long as water conservation prices do not exceed the proportional cost requirement—is questionable.⁸⁸ Under Article X, section 2, reasonableness is determined on a case-by-case basis with statewide concerns in mind. While *Capistrano* was litigated, California was in a continued state of emergency from four straight years of severe drought conditions.⁸⁹ *Palmdale*, on the other hand, was litigated before or possibly even at the beginning of this drought.⁹⁰ Thus, the circumstances in *Palmdale* may be inapplicable to the circumstances in *Capistrano*, where a compelling statewide concern is present. The severe drought conditions during *Capistrano* provide a stronger justification for above-cost water rates—to ensure that the state's severely limited water resources are put to a reasonable and beneficial use. These vastly different environmental circumstances may render *Palmdale* and *Capistrano* incomparable and incompatible. The *Capistrano* Court's overreliance on *Palmdale* without supplementary authority relating to water conservation and resource management is problematic and may discourage meaningful conservation-based water pricing.

Third, *Capistrano*'s use of the term “true cost” is ambiguous. The court uses the term “true cost” as if there were a single determinable value that is judicially verifiable,⁹¹ but such a calculation is impossible.⁹² Even if it were possible, the court inconsistently uses the term throughout the

85. Harris, *supra* note 77, at 7.

86. *Id.*

87. *Id.*

88. *Capistrano Taxpayers Ass'n, Inc. v. City of San Juan Capistrano*, 186 Cal. Rptr. 3d 362, 377 (Cal. Ct. App. 2015) (quoting *City of Palmdale v. Palmdale Water Dist.*, 131 Cal. Rptr. 3d 373, 380–81 (Cal. Ct. App. 2011)).

89. *See* Cal. Exec. Order No. B-29-15, *supra* note 16.

90. *See id.*

91. *Id.* at 372.

If the phrase “proportional cost of the service attributable to the parcel” (italics added) is to mean anything, it has to be that article XIII D, section 6, subdivision (b)(3) assumes that there really is an ascertainable cost of the service that can be attributed to a specific—hence that little word “the”—parcel. Otherwise, the cost of service language would be meaningless.

Id.; *League of California Cities*, *supra* note 77; *Capistrano*, 186 Cal. Rptr. 3d at 362.

92. ASSOCIATION OF CALIFORNIA WATER AGENCIES, *supra* note 64, at 18.

opinion. For example, the court assumes that “true cost” is synonymous with “at-cost” when stating that “nothing in [A]rticle X, section 2, requires water rates to exceed the true cost of supplying that water, and in fact pricing water at its true cost is compatible with the article’s theme of conservation with a view toward reasonable and beneficial use.”⁹³ But then, the court acknowledges that incremental water pricing is a good idea and that in times of drought, water may be more expensive.⁹⁴ The opinion also recognizes that Proposition 218 requires that the agencies figure out the true cost of water, rather than pricing based on water budget.⁹⁵

In terms of economics, however, these statements make little sense. In economics, “true costs” includes all the costs associated with the negative externalities of goods and services.⁹⁶ In advocating for at-cost pricing, the opinion fails to take into account the societal and environmental costs of water, resulting in a contradictory assertion that at-cost pricing is compatible with conservation. That assertion would be accurate under the economic definition of the term, but that is not the case here.

Adding even more confusion, the *Capistrano* opinion later recognized that water prices might be more expensive in times of drought, inadvertently applying the economic definition of “true cost” by internalizing scarcity into the price of water. The *Capistrano* Court illustrated this point by citing to a *Los Angeles Times* article.⁹⁷ The article explained how desalination could be expensive, but added little support as it fails to mention how the estimated costs were derived and whether these costs exceed the “true cost” of water.⁹⁸ The court’s attempt to reconcile at-cost water prices and conservation incoherently applied economic principles in a case about water pricing mechanisms.

Furthermore, this application of water’s “true cost”⁹⁹ is based on the mistaken premise that water service is limited to the cost of “actually

93. *Capistrano Taxpayers Ass’n, Inc. v. City of San Juan Capistrano*, 186 Cal. Rptr. 3d 362, 376 (Cal. Ct. App. 2015).

94. *Id.*

95. *Id.*

96. *True Cost Economics*, INVESTOPEDIA, <http://www.investopedia.com/terms/t/truecosteconomics.asp>.

97. Amanda Covarrubias, *Santa Barbara Working to Reactivate Mothballed Desalination Plant*, L.A. TIMES (Mar. 3, 2015, 4:00 AM), <http://www.latimes.com/local/california/la-me-santa-barbara-desal-20150303-story.html>.

98. *Id.*

99. The opinion also uses the terms “actual cost” and “true marginal cost” interchangeably with “true cost.”

providing water or delivering water in marginal amounts.”¹⁰⁰ However, the California Legislature has endorsed the view that water service means more than just supplying water.¹⁰¹ The Proposition 218 Omnibus Implementation Act, which was enacted to interpret Proposition 218, defines “water” as “any system of public improvements intended to provide for the production, storage, supply, treatment, or distribution of water from any source.”¹⁰² Thus, an entity that produces, stores, supplies, treats, or distributes water necessarily provides a water service.¹⁰³ The court in *Griffith v. Pajaro Valley Water Management Agency* affirmed this interpretation of water service and concluded that water service under Proposition 218 encompasses much more than water delivery.¹⁰⁴

Although the *Capistrano* Court confirmed this interpretation of water service, the opinion later inadvertently contradicted this interpretation. In regard to the holding involving the capital costs of the City’s recycling plant, the *Capistrano* Court found *Griffith*’s analysis controlling.¹⁰⁵ The *Capistrano* Court even recognized that local agencies have the power to “furnish sufficient water in the district for any present or future beneficial use.”¹⁰⁶ And yet, the *Capistrano* Court distinguished *Griffith* in the proportionality requirement analysis, stating “*Griffith* does not excuse water agencies from ascertaining the true costs of supplying water to various tiers of usage.”¹⁰⁷ To the extent the *Capistrano* Court distinguishes *Griffith* to follow constitutional mandates, this Note does not reject *Capistrano*’s application. But, when read in its entirety, *Capistrano*’s interpretation of *Griffith* is contradictory. On one issue, the *Capistrano* Court allowed water rates to include a full-range of service costs to consider and prepare for future water supply shortages; but on the other issue, the court limited the water rate analysis to the present cost of water delivery. Accordingly, the *Capistrano* opinion’s interpretation of the “true cost” of water service is inconsistent throughout the opinion.

100. League of California Cities, *supra* note 77, at 6 (internal quotations marks omitted); *Capistrano Taxpayers Ass’n, Inc. v. City of San Juan Capistrano*, 235 Cal. Rptr. 3d 362 (Cal. Ct. App. 2015).

101. *Griffith v. Pajaro Valley Water Mgmt. Agency*, 163 Cal. Rptr. 3d 243, 250–51 (Cal. Ct. App. 2013).

102. CAL. GOV. CODE § 53750(m).

103. *Griffith*, 163 Cal. Rptr. 3d at 250.

104. *Id.*

105. The opinion refused to extend *Griffith*’s analysis of whether the allocation of water rates is a purely discretionary task. *Capistrano Taxpayers Ass’n, Inc. v. City of San Juan Capistrano*, 186 Cal. Rptr. 3d 362, 376–79 (Cal. Ct. App. 2015).

106. *Id.* at 370 (citing CAL. WATER CODE § 31020).

107. *Id.* at 379–80.

Fourth, the Capistrano Court failed to recognize the fundamentals of the nature and scope of the duties of water service providers.¹⁰⁸ It appears the court assumed that water agencies are just commodity providers,¹⁰⁹ and in assuming so, the court ignored long established authority that suggests otherwise.

In 1910, Justice Shaw recognized that the right to stored water is “of the greatest importance to the future welfare of the state” because it contributes to the growth, prosperity, and wealth of the state, and its ability to support a large population.¹¹⁰ This idea was reiterated in, *Joslin v. Marin Municipal Water District*, where the court stated that it is “[p]aramount among [these state-wide considerations of transcendent importance that] we see the ever increasing need for the conservation of water in the state[.]”¹¹¹ And again in *Griffith*, the court acknowledged that the defendant, a water agency, was created to manage the resources for the common benefit of all water users and that identifying and determining future water supply projects is part of present-day water service.¹¹² Taken together, water agencies are responsible for providing reliable service for not just the present but future generations as well.

Capistrano’s strict interpretation of the at-cost requirement ignores the consequence that heavy water consumers have a greater demand for of water resources that disproportionally affects future water supply. The price of water will inevitably increase in the future when a municipality must expand its water portfolio to compensate for the supply deficiencies. The higher prices for the higher tiers could be described as a reasonable reflection of the wasteful water use that compels conservation in the first place. Under the finding that the City’s upper tiered rates are invalid, the *Capistrano* Court overlooked water agencies’ continuing responsibility to ensure intergenerational reliability. As such, agencies may be discouraged from implementing conservation pricing mechanisms in fear of litigation.

Lastly, the *Capistrano* opinion casts constitutional doubt on any price structure that imposes a penalty rate for excessive water use.¹¹³ In *Capistrano*, the rate structure had four consumption levels in which the revenues from the top consumption tiers were effectively used to subsidize

108. League of California Cities, *supra* note 77, at 6; *Capistrano*, 186 Cal. Rptr. 3d at 362.

109. League of California Cities, *supra* note 77, at 6; *Capistrano*, 186 Cal. Rptr. 3d at 362.

110. *Joslin v. Marin Mun. Water Dist.*, 429 P.2d 889, 894 n.9 (Cal. 1967) (quoting *Miller v. Bay Cities Water Co.*, 107 P. 115, 128 (Cal. 1910); *Griffith v. Pajaro Valley Water Mgmt. Agency*, 163 Cal. Rptr. 3d 243, 254–55 (Cal. Ct. App. 2013).

111. *Id.*

112. *Griffith v. Pajaro Valley Water Mgmt. Agency*, 163 Cal. Rptr. 3d 243, 254–55 (Cal. Ct. App. 2013).

113. *Harris*, *supra* note 77, at 4.

the below-cost rate of the bottom tier.¹¹⁴ In justifying this, the City claimed that Tier 2 was the “basic use allocation,” which provides a reasonable amount of water for the customer’s needs and property characteristics; “Tier 1 was a lower rate for what the City determined to represent “superior or more than reasonable conservation efforts”;¹¹⁵ and Tiers 3 and 4 are “conservation charges” which pursuant to state law “shall be imposed on all increments of water use in the excess of the basic use allocation.”¹¹⁶ Given that the text of Proposition 218 expressly excludes fines, penalties, or other monetary charges imposed as a result of a violation of law, one of the City’s justifications for failing to correlate its higher tiered prices to the cost of service was that these high rates could be categorized as penalties.¹¹⁷ The court rejected this argument because if accepted, the rationale would make a “mockery of the Constitution” and would create a loophole so large that it would virtually repeal Proposition 218.¹¹⁸ The court went on to say all that an agency supplying *any* service would need to do is to create a rate structure with a penalty rate to circumvent Proposition 218.¹¹⁹ This statement suggests that *any* penalty rate is unconstitutional, even if the amounts of the penalties are reasonable and justified.¹²⁰

In addition, this statement could also be read to conflict with the state statute that encourages allocation-based conservation pricing.¹²¹ This could chill drought response efforts and discourage water suppliers from imposing penalties for excessive water use in the future.¹²² The opinion had no reason to address the broader question of the constitutionality of penalty rates because the City had already conceded its failure to meet its burden of demonstrating compliance with the proportionality requirement.¹²³

In sum, the overarching issue is that *Capistrano* could be misused to discourage future water conservation efforts. However, it is important to remember that *Capistrano* does not impose additional limitations on block-

114. *Capistrano Taxpayers Ass’n, Inc. v. City of San Juan Capistrano*, 186 Cal. Rptr. 3d 362, 367–68 (Cal. Ct. App. 2015).

115. CAL. WATER CODE § 372(a)(2) & (a)(3); League of California Cities, *supra* note 77, at 8; *Capistrano*, 186 Cal. Rptr. 3d at 362.

116. CAL. WATER CODE § 372(a)(4) & (b)(1); League of California Cities, *supra* note 77, at 8; *Capistrano*, 186 Cal. Rptr. 3d at 362.

117. *Capistrano*, 186 Cal. Rptr. 3d at 378–79.

118. *Id.* at 380.

119. *Id.* at 378–79.

120. See ASSOCIATION OF CALIFORNIA WATER AGENCIES, *supra* note 64, at 9, 16.

121. CAL. WATER CODE §§ 370(a) & § 372(a)(2)–(a)(4); Harris, *supra* note 77, at 5 n.4.

122. Harris, *supra* note 77, at 5.

123. *Id.*

pricing structures. Agencies have long known that they must comply with Proposition 218; *Capistrano* just reaffirmed this. Moving forward, water agencies can continue to implement tiered water pricing structures so long as they provide a showing of the cost of service at each tier.

IV. Future Litigation after *Capistrano*

Proposition 218 was designed to “constrain local governments ability to impose assessments; place extensive requirements on local governments charging assessments; shift the burden of demonstrating assessments’ legality to local government; *make it easier for taxpayers to win lawsuits; and limit the methods by which local governments exact revenue from taxpayers without their consent.*”¹²⁴ Proposition 218 purports to benefit the taxpayer by discouraging fee or charge increases and in many ways has accomplished this purpose. New water rates will be closely scrutinized, and water agencies bear the burden of proof to justify any price hikes.¹²⁵ After *Capistrano*, water agencies will likely be more concerned about the defensibility of conservation-based pricing schemes.¹²⁶ Thus, the issue becomes how water agencies can continue to impose tiered rate structures without fear of future litigation.

The most obvious solution to avoid Proposition 218 litigation is approval by popular vote.¹²⁷ In doing so, however, water agencies must overcome the obstacles associated with the voting process, such as low voter participation.¹²⁸ Voter approval may also be difficult given taxpayers’ aversion to rate increases, as seen in the passage of Proposition 218. If more than fifty percent of the mail-back ballots oppose the rate hike, then the proposed rate structure will fail.¹²⁹ This is not to say, however, that voter approval of a new rate structure is impossible. There have been circumstances in which the proposals have passed.¹³⁰

124. *Capistrano Taxpayers Ass’n, Inc. v. City of San Juan Capistrano*, 186 Cal. Rptr. 3d 362, 372 (Cal. Ct. App. 2015) (quoting *Silicon Valley Taxpayers Ass’n, Inc. v. Santa Clara Cty. Open Space Auth.*, 187 P.3d 37, 48 (Cal. 2008)) (internal quotation marks omitted).

125. Weber, *supra* note 26, at 829.

126. David Bienick & Fenit Nirappil, *Ruling Forces California Water Districts to Review Rates*, KCRA 3 (Apr. 18, 2017, 10:50 PM), <http://www.kcra.com/article/ruling-forces-california-water-districts-to-review-rates/6421919>.

127. *Capistrano*, 186 Cal. Rptr. 3d at 380–81.

128. George Hostetter, *Fresno’s Prop. 218 Protest Vote Is One for the Ages*, THE FRESNO BEE (Jan. 17, 2015, 5:00 PM), <http://www.fresnobee.com/news/local/article19530942.html>.

129. Weber, *supra* note 26, at 829.

130. CITY OF DAVIS, CITY OF DAVIS WATER RATE INCREASE PUBLIC HEARING (Mar. 19, 2013), <http://cityofdavis.org/home/showdocument?id=1277>; John Holland, *TID Approves Large Water Rate Hike*, MERCED SUN-STAR (Jan. 13, 2015), <http://www.mercedsunstar.com/news/local/article6377517.html>.

On the other hand, if choosing to bypass this rate approval process, water agencies must demonstrate that the allocation of the cost of service complies with the substantive requirements of Proposition 218. Although *Capistrano* stands for the idea that there must be a demonstration of this proportionality requirement, it is instructive as to what is insufficient to pass muster under Proposition 218.

In *Capistrano*, the City allocated the total costs to meet anticipated revenues from all four tiers.¹³¹ The price of each tier increased by consumption: Tier 1: \$2.47, Tier 2: \$3.29, Tier 3: \$4.94, and Tier 4: \$9.05.¹³² The differential between Tier 1 and 2 was 1/3, the differential between Tier 2 and 3 was 1/2, and the differential between Tier 3 and 4 was 5/6.¹³³ The *Capistrano* opinion noted that the fractional precision of the difference between the tiers suggested that the City did not attempt to correlate its rates with the cost of service because such mathematical tidiness is rare in multi-decimal calculations.¹³⁴ In addition, the City followed the recommendations of its rate consultant, and applied the nationally recognized industry ratemaking standards established by the American Water Works Association's ("AWWA"), Principles of Water Rates, Fees and Charges: Manual of Water Supply Practices M1 ("M1 Manual").¹³⁵ The *Capistrano* Court stated that such a manual used by utilities throughout the West Coast might show that an approach is reasonable, but it cannot excuse utilities from ascertaining the cost of service.¹³⁶ The City was unable to show the costs at consumption levels that would require more expensive supplies. Such computations, however, would have satisfied Proposition 218.¹³⁷ Given the facts of *Capistrano*, water agencies should develop an administrative record that identifies the marginal costs of providing water service at each tier.

Water agencies should look at cases that have survived judicial scrutiny for guidance as to what is sufficient to meet the substantive requirements of Proposition 218. For example, in *Griffith v. Pajaro Valley Water Management Agency*, the court upheld a tiered charge imposed for

131. *Capistrano Taxpayers Ass'n, Inc. v. City of San Juan Capistrano*, 186 Cal. Rptr. 3d 362, 366 (Cal. Ct. App. 2015).

132. The city did not make a profit on these structures. *Id.* at 367–68.

133. *Id.* at 370–71.

134. *Id.*

135. Application for Leave to File Amicus Curiae Brief by Natural Resources Defense Council and Planning and Conservation League; Brief of Amici Curie in Support of Appellants, *Capistrano*, 186 Cal. Rptr. 3d 362 (No. G048969). The M1 manual is the most widely used rate setting manual among public water purveyors nationally.

136. *Capistrano*, 186 Cal. Rptr. 3d at 378–79.

137. *Id.* at 380–81.

groundwater distribution based on the geographical differences in the parcels.¹³⁸ The water agency established revenue requirements consistent with industry standards set forth in the M1 Manual and then prepared the cost of service allocations.¹³⁹ The court ultimately found that the plaintiffs were unable to establish that grouping water users based on location was an unreasonable way to apportion the cost of service.¹⁴⁰ The court also noted that Proposition 218 only requires that the apportioning fee or charge shall not exceed the proportional cost of service attributable to the parcel, but it does not proscribe a particular method to accomplish this.¹⁴¹ Like *Capistrano*, the water agency in *Griffith* also relied on the M1 Manual to determine its water rates, however, rate variations were also related to property location. This distinction is informative in that water agencies, at the very least, must provide supplemental justifications for rate structures in addition to following industry standards.

This conclusion is reaffirmed in the case, *Morgan v. Imperial Irrigation District*.¹⁴² In *Morgan*, individuals challenged the water agency's cost of service study on the grounds that the data was poor and therefore insufficient to meet the proportionality requirement.¹⁴³ There, the cost of service study had also followed the professional standards developed by the AWWA, but the water agency specified that it took into account the character of the water district and its customers.¹⁴⁴ Specifically, the study noted cost differentials between some types of services, such as the size of water pipe and parcel and type of use (municipal, industrial, or agricultural).¹⁴⁵ The study used historical costs and projections of future costs to determine the revenue requirements recovered by water rates.¹⁴⁶ In calculating consumption for every category of service, the study used clear measurement data.¹⁴⁷ However, when this

138. *Griffith v. Pajaro Valley Water Mgmt. Agency*, 163 Cal. Rptr. 3d 243 (Cal. Ct. App. 2013).

139. The agency established their revenue requirements by: (1) taking the total costs of chargeable activities, (2) deducting the revenue expected from other sources; and (3) apportioning the revenue requirement among the users. *Id.* at 255.

140. *Id.*

141. *Id.*

142. *Morgan v. Imperial Irrigation Dist.*, 167 Cal. Rptr. 3d 687, 693–94 (Cal. Ct. App. 2014). Note that this case did not involve a tiered block structure.

143. *Id.*

144. *Id.* The cost of service study here was based on cost of service principles and not value of services principles.

145. *Id.*

146. *Id.*

147. *Id.* at 94–95.

data was unavailable, the study created average use calculations from the water district's staff to estimate data and buttressed these estimates with data published in the AWWA, data for local municipalities, and local evapotranspiration rates.¹⁴⁸ Given these processes, the *Morgan* Court held that the cost of service study was reliable and supported by substantial evidence.¹⁴⁹ The court further stated that even though the data in the measurement study was not perfect Article XIII D, section 6 in Proposition 218 does not require perfection.¹⁵⁰ In comparing *Morgan* and *Griffith* to *Capistrano*, it is clear that a mere reliance on AWWA's M1 Manual is insufficient to sustain a challenge to the proportionality requirement. Rate structures that attribute price differentials to geographic location or the character of the water district or its customers are more likely to pass judicial scrutiny.

Going forward, water agencies also have the option to factually distinguish their rate structures or circumstances from *Capistrano*. The water agency in *Capistrano* did not provide a calculation of actual costs; accordingly, a showing of some calculations of actual costs provides water agencies with a compelling argument to differentiate their rate structures. Water agencies can also argue that *Morgan* and *Griffith* are more persuasive. In pursuing these options, water agencies do so at their own risk. Until the California Supreme Court issues further guidance clarifying the controlling rule for the proportionality requirement, water agencies should work to improve their administrative records to increase accountability and transparency of water rates in order to avoid future litigation. In doing so, municipalities must identify varying costs of existing water supply to justify incremental costs and must be able to explain how these charges comply with Proposition 218. Water agencies should provide economic and engineering analyses for their cost accounting methods to support their water rate design. Water pricing is burdensome and complex because it must take many variables into account. However, this is the exact type of information that voters called for by passing Proposition 218.

The procedural and substantive requirements of Proposition 218 are not the only factor in ratemaking. The primary responsibility of water agencies is to ensure reliability for both present and future generations.¹⁵¹

148. *Morgan v. Imperial Irrigation Dist.*, 167 Cal. Rptr. 3d 687, 694–95 (Cal. Ct. App. 2014).

149. *Id.* at 708–10.

150. *Id.* at 708–09.

151. *Joslin v. Marin Mun. Water Dist.*, 429 P.2d 889, 894 n.9 (Cal. 1967) (quoting *Miller v. Bay Cities Water Co.*, 107 P. 115, 128 (Cal. 1910), *overruled by* *City of Lodi v. East Bay*

Municipalities must broaden the perception of water prices from the cost of delivery to reflect the value of water to society. Cases like *Capistrano* have presumed that “cost” applies to the delivery costs of water and that a quantifiable price exists, but there are no cases that explicitly address the validity of capturing the non-monetized economic costs under the ambit of Proposition 218.¹⁵² Rather, California law¹⁵³ and precedent supports the notion that water agencies should consider the intergenerational reliability of water supply. Recognition of this non-monetized temporal aspect to water itself affirms that the nature and scope of water supply is not limited to delivery.¹⁵⁴ The legality of incorporating the non-monetized cost of water will ultimately depend on whether the value of water falls within the “cost of service,”¹⁵⁵ but there is no judicial or economic reason as to why the cost of water should be limited to capital costs and water service operations and maintenance costs.

At a minimum, at-cost pricing should expand from the price of water delivery to encompass the costs of avoiding, mitigating, or restoring environmental impacts in the present year.¹⁵⁶ A further step would include the opportunity cost of using the public’s resources within the at-cost value.¹⁵⁷ This would assume a duty to restore the diminished water supply. If a duty exists, the costs required to provide a public water supply could be considered costs within Proposition 218.¹⁵⁸ If no duty exists, then the cost would be measured at the cost of delivery.¹⁵⁹

As previously mentioned, determining the price of water that represents its full value is difficult to quantify. Often, the minimum value is all that can be determined.¹⁶⁰ Though including a minimum value to reflect the non-monetized water value in the cost of service calculations will need justification from expert economic opinion,¹⁶¹ it will provide a

Municipal Utility Dist., 60 P.2d 439 (Cal. 1936); *Griffith v. Pajaro Valley Water Mgmt. Agency*, 163 Cal. Rptr. 3d 243, 254–55 (Cal. Ct. App. 2013)).

152. Weber, *supra* note 26, at 815.

153. State law explains that it is in the best interest of the people of California to encourage public entities to voluntarily use allocation-based conservation water pricing, tailored to local needs and conditions, as a means of increasing water use efficiency and discouraging waste in both normal and dry-year hydrologic conditions. CAL. WATER CODE § 370(b).

154. *Joslin*, 429 P.2d at 894 n.9 (quoting *Miller*, 107 P. at 128, *overruled by East Bay Municipal Utility Dist.*, 60 P.2d at 439; *Griffith*, 163 Cal. Rptr. 3d at 254–55).

155. Weber, *supra* note 26, at 821.

156. *Id.* at 822.

157. *Id.*

158. *Id.* at 823.

159. *Id.*

160. *Id.*

161. *Id.*

more accurate price signal to consumers about the societal value of water. This expanded interpretation of the cost of water recognizes water agencies' responsibility to provide a reliable water service for all generations and will have a greater impact on consumption behavior.

Ultimately, courts review these cases not to determine what is right or reasonable to preserve this system created but rather to determine whether water plans comply with the constitutional mandates chosen by the voters.¹⁶² In passing Proposition 218, voters made clear that water agencies may raise the price of water, but they must do so with their consent or in a way that correlates to the cost of providing that water. After *Capistrano*, tiered water pricing structures remain compatible with the California Constitution, but an agency must do more than just balance the total costs of service with its total revenue and industry standards. An agency must be able to provide supplemental cost accounting justifications for any given tier. In this process, agencies should broaden their interpretation to encompass both the monetized and non-monetized value of water. By doing this, agencies will be better equipped to deal with California's changing hydrology and future population growth.

Conclusion

Climate change has amplified the severity of droughts in California. Californians must prepare for the possibility of more frequent and persistent periods of limited water supply. Market-based conservation practices and, more specifically, increasing block-pricing structures are important tools to mitigate these impacts on California's water supply.

Although *Capistrano* raises concerns in implementing block rate structures, municipalities should not be discouraged from implementing them because block-pricing structures remain constitutional. The lesson from the *Capistrano* decision is that municipalities must justify the prices for each corresponding tier, improve their cost-accounting techniques, and document incremental costs that affect the cost of delivery for current and future cost of service studies.

Municipalities should also look past the actual costs of delivering water to incorporate the full cost of water use, including environmental detriment, intergenerational equity, and scarcity. Although it is difficult to ascertain the full value of water, it is imperative that municipalities at the very least incorporate future supply and demand predictions to set a price

162. *Capistrano Taxpayers Ass'n, Inc. v. City of San Juan Capistrano*, 186 Cal. Rptr. 3d 362, 364 (Cal. Ct. App. 2015).

for water that is more reflective of its full value. After all, “We [will] never know the Worth of Water, till the Well is dry.”¹⁶³

163. THOMAS FULLER, *GNOMOLOGIA: ADAGIES AND PROVERBS, WISE SENTENCES AND WITTY SAYINGS, ANCIENT AND MODERN, FOREIGN AND BRITISH* 237 (1732).